

**FINANCIAL INSTITUTIONS COMMITTEE MEETING**  
**Business Law Section, State Bar of California**

Meeting of January 10, 2006

**Committee Members Present:** John Hancock, Chair; Meg Troughton, Vice Chair; Rosie Oda, Secretary; Michael Abraham; Bruce Belton; Leland Chan; Laura Dorman; Bart Dzivi; Mark Gillett; Robert Hale; Linda Iannone; Kenneth Krown; Todd Okun; Allan Ono; Robert Stumpf; Keith Ungles; and Richard Zahm.

**Committee Members Absent:** Andrew Druch; Jim Dyer; Jay Gould; Randy Kennon; Rosemary Lemmis; Teryl Murabayashi; Brad Seiling; and Russ Schrader.

**Advisory Members and Others Present:** Clay Coon; Ted Kitada; Bob Mulford; Michael Occhiolini; Isabelle Ord; Jim Rockett; Neil Rubenstein; and Maureen Young.

**Call to Order:** Chair John Hancock of World Savings called the meeting to order at 9:30 A.M.

**Welcome to Members and Advisory Members:** John welcomed the Committee Members and the Advisory Members and asked each person to identify themselves and where they worked.

**1. Approval of December 13, 2005 Minutes:** The Committee approved the minutes of the December 13, 2005 meeting, subject to two minor edits to be made and possible submission of an exhibit by Ted Kitada of Wells and Bob Mulford, Consultant.

**2. Report on Change in Notarial Acknowledgements:** Neil Rubinstein of Buchalter reported on Assembly Bill No. 361, which was signed by the Governor on September 22, 2005 and amends Section 1189 of the Civil Code among other provisions. This amendment provides criminal penalties for a notary public that willfully fails to perform required duties, in particular, the notary acknowledgement. Apart from criminalizing this activity, Neil commented that its effect may or may not be significant. Previously, the law recognized a form of acknowledgement to be used in the State of California. Under the new law, instead of being in substantially the required the form, it "shall be" in that form. Neil noted that there are many various uses of notarial acknowledgement besides being able to record property; it could be required by statute, and the Evidence Code provides that it is prima facie evidence that signatures are valid and the facts stated in the document are valid. Thus, the change in statutory language could potentially invalidate the notarial acknowledgement, or as John pointed out, cause the loss of the presumption if it is not in the right form. Neil described the possibility that in a default hearing, the plaintiff might be put in a position of not being able to prove a claim, for example a guarantee, for lack of an appropriate notarial acknowledgement.

**3. Proposed Jury Trial Waiver (*Grafton*) Legislation:** Neil also reported that the Corporations Legislative Subcommittee attempted to rewrite the legislation, but

reconsidered after realizing that their attempt created ambiguities. They are now trying to coordinate with the Civil Justice Association of California (“CJAC”), a business lobbying group, on the legislation. In response to Jim Rockett of Bingham McCutcheon Neil said that there is no organized opposition to legislation but that the Judiciary Committees of the legislature will be the hardest hurdles to enactment. Leland Chan of the CBA said that they were supporting CJAC but were not taking a leading role in this legislative effort.

**4. Changes to Regulation E:** Ted Kitada of Wells reported on changes to the Federal Reserve Board’s Regulation E, 12 C.F.R. Part 205, which implements the Electronic Funds Transfer Act (“EFTA”), under its interim and new final rules. The final rule has a three year sunset and covers electronic check conversion transactions, known as ECK, and paroll card accounts. Ted described the new final rules as the most significant changes to Reg E in a while.

Previously, merchants accepting ECKs were not subject to Reg E. Now they are treated as financial institutions and must prepare notices to satisfy NACHA rules even though NACHA does not provide models. Consumers are considered as authorizing the ECK transaction as an EFT, and would receive notice that the transaction will be processed as an EFT rather than a check. Ted pointed out that banks should review merchants’ notices. A lively discussion ensued, prompted by comments from Bob Mulford. Meg Troughton of BofA commented out that these transactions benefit the merchants, which thereby get same day funds. Laura Dorman of Citi noted that her bank is a party to a 17200 suit (under the Business and Professions Code) for the order in which the bank processes debt transactions and checks, which are not done on a real time basis. Bob Stumpf of Sheppard noted that there is commentary as to use of good faith in determining the posting order.

Ted then discussed the interim rule and noted that the approach taken with respect to payroll cards is similar to that taken with respect to electronic benefit transfer cards. With regard to the periodic statement requirement, instead of mailing a hard copy, the issuer may provide balance information by telephone or provide electronic access. There is an issue as to which escheat period applies to these cards, whether they are treated as payroll or as deposits. Some discussion ensued as to the nature of payroll cards, which were originally intended for use by the unbanked, such as migrant workers, but which Meg pointed out are mainly being used by teenaged part-time workers.

**5. Fair Credit Reporting Act (“FCRA”) Exam Procedures:** Our reliable, erudite instructor, Maureen Young of Bingham McCutcheon explained the agencies’ examination procedures. She pointed out that these procedures precede final regulations under the FCRA but, nevertheless, the agencies issued them anyhow and appear to assume that they will be enforced as if based on final regulations. She recommended that Appendix A is a useful tool for operational purposes as it lays out what the agencies expect to find for compliance.

**6. New FinCEN Regulation implementing Section 312 of the USA PATRIOT Act:**

Maureen also reported that FinCEN's final rule, which was preceded by the interim rule in 2002, doesn't indicate heightened enforcement, particularly since scores of enforcement actions involving correspondent accounts have already taken place before the issuance of these final rules. Although the agencies view the new rule, which was issued on December 21, 2005, as more narrow and institution-friendly, all of the statutory principles are still in place, and money services businesses are still subject. Banks must use diligence in monitoring correspondent accounts, and they must use diligence in handling private banking accounts involving politically exposed persons ("PEPs"). A proposed rule, also issued under Section 312, describes enhanced due diligence procedures to exclude offshore branches of foreign banks in regimes determined by the U.S. to be adequately supervised. It is now up to financial institutions to decide whether foreign correspondent banks are adequately scrutinizing their customers. Maureen advised that the rule does not appear much different than the statute or the interpretations of it as represented by previous enforcement actions. Section 312 does not signal the commencement of scrutiny, banks have been under it already.

**7. Exotic Mortgages:** Richard Zahm of Second Angel commented on the proposed Interagency Guidance on Nontraditional Mortgage Products issued on December 29, 2005. Richard opined that the guidance demonstrated a misunderstanding of real estate lending. He says that this type of "nontraditional" real estate lending, for example involving interest-only mortgages, has been going on for years. Richard also took issue with talk about a real estate bubble, pointing out that residential foreclosures are at near record lows. He described the current overall market condition as a "pause", that the economy was in excellent shape but that lenders were beginning to put pressure on mortgage brokers. Richard pointed out some ways in which the mortgage industry can control risk and financing decisions. For example, a lender can raise the level of scrutiny required for approval by substituting two appraisals with five comparables for a single drive-by appraisal, or by requiring color photos of each comparable. Lenders can also increase the degree of excruciating detail required for income verification. Richard believes that the consumer is not at risk, lenders are, and ultimately Wall Street is causing the "federalizing" of Mom and Pop mortgage brokers. Meg commented on the practice of so-called "stated income" lending that allows buyers to avoid furnishing verification of stated income in exchange for a higher interest rate.

**8. Federal Legislative Report:** Bart Dzivi reported that the Regulatory Relief bill has been passed by both Houses with identical Deposit Insurance Reform provisions on IRA accounts and indexing accounts. The FDIC premium structure will be changed to give the FDIC more discretion in setting rates. The House is in recess until February.

**9. State Legislative Report:** Bob Mulford reported by email prior to the meeting that State legislative matters are not really underway yet.

**10. Miscellaneous:** Bob Mulford brought an interesting check processing case to our attention, *Wells v. Citizens Bank of Texas*, 2005 WL 3148061, dealing with a remote disbursement account where Wells routed checks written on Texas accounts through

Ohio a day or two later than if they had been routed through Texas. Wells has won this case so far.

**11. Fall Bar Meeting Presentation:** Isabelle Ord of Sheppard mentioned that her subcommittee is still looking for panelists for the Bar meeting later this year.

**12. Sacramento Trip in February:** John reminded us that our February meeting will be held in Sacramento for our annual Legislative presentation arranged by the CBA. Rosie Oda of Pillsbury volunteered to look into arrangements for us to travel to Sacramento as a group on the same train.

**13. Adjournment:** The meeting was adjourned at 11:22 A.M.